Ontario

Modernizing the Credit Unions and Caisses Populaires Act

A Consultation Document on the 2005 Review of the Act

Ministry of Finance
November, 2005

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MINISTRY OF FINANCE
NOVEMBER, 2005

Dear Stakeholder,

The Ministry of Finance is pleased to provide you with a copy of these proposals to modernize the regulation of credit unions and caisses populaires in Ontario.

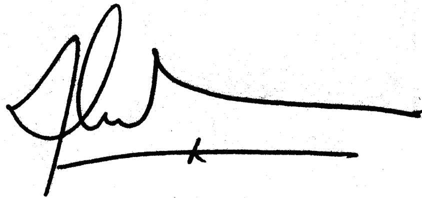
During the past year, the government, in collaboration with the Financial Services Commission of Ontario and the Deposit Insurance Corporation of Ontario, has been working with representatives of credit unions and caisses populaires to identify improvements to the *Credit Unions and Caisses Populaires Act, 1994*. This exercise is part of the government's commitment to modernize financial sector regulation and support a new generation of economic growth.

The proposals described in this document are intended to enable credit unions and caisses populaires to serve their customers better and compete in the financial services marketplace. The proposals are also intended to enhance the sector's stability, which is also an essential component of its competitiveness.

The ministry is interested in receiving input from individual credit unions and caisses populaires, their members, and others. Your views will assist the ministry in finalizing proposals to update the Act and regulations.

Thank you for contributing to this important review.

Sincerely,



Dwight Duncan
Minister of Finance

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I. INTRODUCTION

In the 2004 Ontario Budget, the Government of Ontario committed to reviewing the *Credit Unions and Caisses Populaires Act, 1994 (CUCPA)* with an intent to introduce amendments to this Act by the end of fiscal 2005-06. This document is being circulated to give interested persons a summary of the proposals.

Credit unions and caisses populaires play an important role in delivering financial services to Ontario's consumers, particularly in areas under-served by banks and other providers. The financial services sector continues to undergo rapid change in the province, across Canada and around the globe. Ontario needs to ensure that its regulatory system does not unnecessarily impede credit unions and caisses populaires as they work to keep pace with these changes to be competitively positioned, and to continue to grow and innovate.

While formulating many of the proposals contained in this document, the Ministry of Finance sought the input of the following organizations and agencies:

- Coalition of Credit Unions and Caisses Populaires of Ontario
  - Association of Credit Unions of Ontario
  - Credit Union Central of Ontario Limited
  - L'Alliance des caisses populaires de l'Ontario limitée
  - La Fédération des caisses populaires de l'Ontario Inc.
- Deposit Insurance Corporation of Ontario
- Financial Services Commission of Ontario

The proposals are intended to modernize the legislation and regulations governing credit unions and caisses populaires so that they can continue to provide Ontarians with the access to financial services they require, and so that the sector can continue to compete effectively in the financial services marketplace. These proposals would also streamline regulatory processes and enhance the ability of credit unions and caisses populaires to manage risk, strengthen governance, increase efficiency and improve consumer protection. Please note that any references to credit unions throughout this document are intended to include caisses populaires, unless otherwise stated.

Your views are being sought on these proposals. Note that the proposals would only become law if the Legislative Assembly passes such legislation.

Interested parties are invited to make written submissions by December 16th, 2005.

You may send comments by mail, fax or e-mail to:

Modernizing the Credit Unions and Caisses Populaires Act, 1994
c/o Industrial & Financial Policy Branch
Ministry of Finance
777 Bay Street, 10th Floor
Toronto, ON M5G 2C8
Fax: 416-327-0941
E-mail: cucpconsultations@fin.gov.on.ca

A copy of this consultation document can be reviewed online at www.fin.gov.on.ca.

Please note that this is a public consultation. All comments received will be considered public and may be used by the ministry to help evaluate and revise the legislative proposals. This may involve disclosing some or all comments or materials, or summaries of them, to other interested parties during and after the consultation. Personal information will not be disclosed without prior consent.

If for any reason you feel your comments should not be shared with other parties, please indicate this in your covering letter. Please note that all submissions received are subject to the *Freedom of Information and Protection of Privacy Act*.

If you have any questions about this consultation or how any element of your submission may be used or disclosed, please contact:

Luba Mycak
Senior Manager
Industrial & Financial Policy Branch
Ministry of Finance
777 Bay Street, 10th Floor
Toronto, ON M5G 2C8
Tel: 416-326-9227
Fax: 416-327-0941

II. INCORPORATION, MEMBERSHIP, AND GOVERNANCE

The Ministry of Finance is proposing to modernize the legislative framework applicable to the incorporation, membership, and governance of credit unions and caisses populaires. The following sets out examples of some of the proposals.

1. Incorporation

It is proposed that the statutory requirements for incorporating a credit union be streamlined. For example, although the legislation provides that the Minister is responsible for issuing a certificate of incorporation and a certificate of amalgamation, in practice the Minister has delegated authority to the Superintendent of Financial Services. It is proposed that the legislation be updated to reflect the actual streamlined practice.

It is also proposed that an incorporating credit union be able to specify in its by-laws a minimum and maximum number of directors, provided that the minimum is not fewer than five directors.

2. Continuance

Some credit unions are exploring ways in which they can provide services to their members on a national basis and have considered continuing as federally regulated institutions under the *Bank Act*, *Trust and Loan Companies Act*, or *Cooperative Credit Associations Act*. Continuance is the legal process by which a corporation can change its jurisdiction of incorporation. It is proposed that Ontario's *Credit Unions and Caisses Populaires Act, 1994* be amended to permit the continuance of a credit union under federal or other provincial legislation. As well, it is proposed that credit unions from other provinces and federal financial institutions have the ability to transfer to the Ontario jurisdiction and become Ontario incorporated credit unions.

3. Bonds of association

Currently, the by-laws of every credit union must limit its membership to persons or entities who come within a defined bond of association. The permissible bonds are set out in legislation and include a common occupation or association or a residence or employment within a defined community. Credit unions may amend their by-laws to change the bond of association, but the by-laws are subject to the approval of the Superintendent.

It is proposed that credit unions be permitted to define their own bonds of association, and that the definition not be constrained by the legislation. It is also

proposed that credit unions not be required to obtain the approval of the Superintendent when amending their by-laws dealing with bonds of association. This is a matter more appropriately left to the members and their governing boards. This streamlined approach will be of particular benefit to credit unions that are merging with other credit unions and redefining their membership base.

4. Governance

Credit unions are democratic organizations owned and controlled by their members. The legislative framework should facilitate improvements in democratic processes. One of the responsibilities of membership is to participate actively in setting policies and making decisions for the benefit of the credit union as a whole. Those who are elected to represent the membership are accountable for the development, growth, and success of their credit union. Good corporate governance is essential to the well-being of a credit union. For these reasons, it is important that credit unions serve their members in an effective and responsible manner. To achieve this goal, credit unions should have more autonomy to establish their own internal governance rules. For these reasons, it is proposed that governance be improved by:

- removing the authority for the Superintendent to order a member or shareholder meeting when the board fails to do so when presented with a requisition for such meeting signed by at least five per cent of members;
- removing the power to prescribe training programs for directors and instead requiring a credit union to set its own training requirements;
- removing the requirement for credit unions to establish credit committees;
- adding clarification on corporate governance matters such as the definition of “officer” and the required committees of the board;
- allowing members to attend and participate in annual general meetings by using video conference, electronic voting or similar modes of communication.

III. CAPITAL AND LIQUIDITY

1. Capital adequacy

In order to ensure their financial stability, Ontario credit unions are required to meet prescribed capital standards. Capital requirements are comprised of two elements – a leverage test and a risk-weighted test. Under the leverage test, a credit union must maintain regulatory capital equal to at least five per cent of its

total assets. In addition, a credit union must maintain regulatory capital equal to at least eight per cent of its risk-weighted assets. The second test measures the credit risk of specific assets. This dual-test framework is similar to the requirements imposed on federally regulated deposit-taking institutions and on credit unions in other provinces by their governing legislation.

The risk-weighted test currently applied to Ontario's credit unions is derived from the international standards agreed upon in 1988, and updated in 1996 at the Bank for International Settlements in Basel, Switzerland. These standards are often referred to as the Basel I capital rules. Although initially the Basel I accord was applied only to internationally active banks in the G10 countries, it has become a recognized standard in many jurisdictions.

In 2004, a revised Basel capital accord (Basel II) was endorsed for implementation by 2008. The Basel II framework consists of three pillars. The first pillar calculates the required minimum capital based on levels of credit, market and operational risks. The second pillar is based on an assessment of internal management processes, such as risk management and accountability of managers. This pillar is intended to encourage the development and use of better techniques in managing and monitoring risk. The third pillar focuses on enhanced disclosure and requires reporting of risks and capital levels available to cover those risks. This pillar is intended to enhance market discipline, through shareholder evaluation of publicly-owned financial institutions.

It is proposed that Ontario adopt the Basel II approach to the supervision of credit unions including revising its risk-weighted test to be comparable with the weightings proposed by the Office of the Superintendent of Financial Institutions (OSFI) for federally regulated institutions. Accordingly, standardized risk-weights could be revised as follows:

- 35% for uninsured first mortgages on residential dwellings of one to four units (currently 50%);
- 75% for personal loans (currently 80%);
- 75% for agricultural loans (currently 80%);
- 100% for commercial loans, unless borrower has an external credit rating, in which case rating can be 20%, 50%, 100%, or 150% (currently 100%);
- 150% for past-due loans if specific provisions are less than 20% (currently no penal provisions for delinquent loans).

With respect to operational risk, it is proposed that credit unions be required to maintain capital equivalent to 15% of the average financial margin for the preceding three years. It is proposed that a credit union's board of directors or

the regulator may require a higher proportion if the operational risk of an individual credit union is higher.

It is proposed that credit unions be required to set aside sufficient capital to cover interest rate risk. A credit union would be required to measure and report to the regulator its interest rate risk based on reasonable assumptions for expected changes in interest rates, and would be required to maintain capital sufficient to cover the interest rate exposure. The regulator would have the capacity to require additional capital coverage for interest rate risk.

Under the Basel II framework for international banks, business loans that do not exceed $1.25 million are classified as personal loans. While it is useful to have a threshold amount that will define personal loans, the quantum under the Basel II framework is not appropriate for Ontario's credit unions, given their comparatively small asset base. For this reason, it is proposed that business loans under $25,000 will continue to be classed as personal loans for lending purposes; and business loans over that amount that do not exceed the lesser of 3.5 basis points of total assets or $1.25 million be included as personal loans for the purposes of the risk-weighting calculation by credit unions. This amount would provide Ontario's largest credit unions the same threshold ($1.25 million) as banks for the purpose of risk-weightings.

The attached Appendix provides greater detail on the proposals for the risk-weighting of credit union assets, and how the proposals compare to current requirements, and to the expected rules for Canadian banks.

Many Ontario credit unions are eager to adopt the Basel II rules and have asked the Ontario government to consider eliminating the leverage test, relying solely on the Basel II risk-based capital test. However, capital is a fundamental element of the credit union system's financial soundness and there is no experience yet with the implementation of Basel II pillars and tests. Adequate capital may not be achievable under a Basel II test alone. For this reason, it is proposed that the leverage test be retained for Ontario's credit unions for the time being. This recommendation also reflects the approach taken by other jurisdictions. OSFI has indicated that it will maintain a leverage test for banks and federal financial institutions for supervisory purposes.

Credit unions that need to report on the basis of the Basel II rules will require significant systems of control and data management. The capital test is designed to measure risk more accurately across a broad range of activities, but not all credit unions take on risks of this breadth.

It may be appropriate for less complex and smaller credit unions to be required only to meet the leverage test, and not the risk-based test. Consideration is being given to allowing less complex credit unions to be subject only to the current five per cent leverage test. It is proposed that less complex credit unions be defined as those with $50 million or less in assets and with no commercial lending.

2. Liquidity

Liquidity refers to the ability of a credit union to meet its cash commitments as they arise. For adequate liquidity, a credit union needs to be able to maintain or generate sufficient cash in a timely manner and at a reasonable cost. These commitments can usually be met through liquid assets - that is, available cash on hand or investments and other assets that are readily convertible into cash or short-term borrowings.

Under the current regulations to the Act, credit unions must maintain specific amounts and qualifying forms of liquid assets or else they must stop their lending activities. Credit unions can also make arrangements to deposit excess liquidity funds in, or borrow needed liquidity funds from, a liquidity pool managed by a league.

One rationale for improving liquidity requirements is cross-sector competitiveness. For example, banks do not have to adhere to quantitative liquidity requirements. Instead, they have to maintain liquid assets that are prudent in relation to their operational needs. Prescriptive liquidity requirements may limit credit unions' earnings growth to the extent that they do not have as much flexibility as banks in designing and maintaining liquidity appropriate to their needs.

For these reasons, a "prudent-person" approach is proposed for liquidity regulation. Detailed liquidity requirements would be replaced with the general requirement for credit unions to maintain liquid assets that are prudent in relation to their operations. It would be the responsibility of each credit union to determine its liquidity needs and maintain adequate liquidity. The regulator, however, would retain the ability to require a credit union to provide additional liquidity if necessary.

Alternatively, less complex credit unions which have opted out of the Basel II capital requirement would not qualify for the prudent-person approach for liquidity but be subject to prescriptive rules. Rules governing liquidity will be updated and kept for these institutions.

IV. BUSINESS POWERS

1. Insurance retailing

Although credit unions are permitted to own insurance companies as subsidiaries, current rules restrict the types of insurance credit unions can administer. These rules are similar to the restrictions imposed by federal legislation on banks and trust companies.

A credit union cannot underwrite insurance and it cannot act as an agent for any person in the selling of insurance. As well, it cannot lease or provide space in its offices to any person selling insurance. A credit union's premises must be separate and distinct from the premises of an insurance company, agent, or broker. A credit union cannot provide its customers with a communications link in its offices (e.g. telephone) to an insurance company, agent, or broker.

Credit unions may administer an "authorized type of insurance" in their branches such as insurance on a credit card, creditors' life or disability insurance, group life and sickness insurance, mortgage insurance, and travel insurance.

A credit union's ability to promote insurance products, insurance companies, brokers or agents in branch is restricted to this narrow range of authorized types of insurance. Credit unions may conduct promotions on a broader range of products and services outside their branches, but are not allowed to target these promotions at specific customers.

Credit unions are seeking expanded power to sell insurance "in branch" as a way to provide a broader range of financial services to their members. Credit unions also suggest that they have a potential role to play in providing insurance to residents in rural and remote communities. The views of interested parties are being sought on this matter.

2. Prudent standards and lending licences

Although credit unions are required to articulate and apply prudent standards when making investment and lending decisions, they must also comply with detailed quantitative and qualitative limits that are prescribed in the regulations. In addition, credit unions may only engage in certain types of lending by applying to the Superintendent for a lending licence which may contain such conditions and restrictions as he or she considers appropriate. The classes of lending licences that may be issued, lending limits on loans by class, and a prescriptive list of eligible investments are also prescribed by regulation. This detailed regime is backed up by regulatory inspections and examinations that look at results of credit union lending and investment decisions.

It is important that Ontario's credit unions have appropriate flexibility to establish a loan and investment portfolio that reflects a risk level suitable for their circumstances. As a result, it is proposed that legislation be amended to remove most prescriptive quantitative and qualitative rules and to remove the requirement to obtain lending licences. Each credit union would be required to establish its own prudent lending limits for all lending activity. It is important, however, that regulatory oversight over policies be retained and that the regulator retain the authority to limit lending if problems at individual credit

unions arise. In addition, it is proposed to retain lending licences and some prescriptive regulations on lending for small and less complex credit unions.

It is also proposed that the 1.25% limit on maximum aggregate lending to single entities and connected persons and on syndicated loans be retained in regulations.

3. Investments in subsidiaries

Under the current rules, credit unions are permitted to invest in prescribed subsidiaries with the approval of the Superintendent. The list of prescribed subsidiaries is set out in the regulations and includes a financial institution, a financial leasing corporation, an investment counselling and portfolio management corporation, and a mutual fund corporation among others. It is proposed that credit unions continue to be required to obtain the approval of the regulator before investing in a subsidiary. It is proposed that approval be subject to the regulator obtaining an undertaking from the credit union that it will provide information about the activities of the subsidiary on an ongoing basis. It is also proposed that the approved list of subsidiaries be expanded to include an insurance brokerage firm. Given that the list of permissible subsidiaries is in the regulation, there is flexibility to add to the list in the future as the need arises.

No changes are being proposed to the current quantitative limits on investments in subsidiaries. Credit unions would continue to be subject to an aggregate limit of 5% of regulatory capital and deposits.

Currently credit unions are prohibited in making investments in an entity if the credit union would control more than 30% of voting rights in the entity unless the investment is in a subsidiary of the credit union (i.e. more than 50% control). It is proposed to permit an exception to this rule, where the entity is of a type in the list of prescribed subsidiaries, and all voting rights in the entity are controlled by credit unions, whether or not the entity is a subsidiary of one of them. This, for example, would assist if there were three credit unions each wishing to control 1/3 of a qualifying entity.

4. Interprovincial activities

Currently, the Act permits credit unions from other provinces to operate in Ontario provided that an interprovincial agreement is in place allowing reciprocal access for Ontario's credit unions. It is proposed that the legislation continue this policy. It is also proposed that, where a credit union is operating outside its incorporating jurisdiction, deposit insurance coverage for those deposits should be made available by the home province.

5. Unsecured personal loans

In response to requests by the credit union sector and consistent with a prudent person approach, it is proposed that credit unions be allowed to set lending policies that determine whether tangible security be required for individual personal loans.

6. Syndicated loans

A credit union may loan money only to its members. As a result, a borrower must be a member of each credit union participating in a syndicated loan. This standard is not necessary to ensure adequate information flow and financial administration of the loan. It is proposed that borrowers only be required to be a member of one of the credit unions participating in a syndicated loan.

Currently a credit union may act as administrator or syndicating credit union if it lends at least ten per cent of a loan made under a syndicated loan agreement. It is proposed that this rule be maintained. It is also proposed that only credit unions with sufficient resources and expertise be allowed to act as loan administrators with specified duties and rights.

7. Collateral mortgages

Credit unions assert that the current rules governing collateral mortgages place them at a competitive disadvantage and discourage them from taking additional real property as security for personal loans, particularly when the borrower has a residential mortgage outstanding that represents 75% of the value of the property. It is proposed that, notwithstanding the 75% loan-to-value ratio limit, a credit union could take the property as collateral to a personal loan provided that the portion of the collateral mortgage beyond the 75% loan-to-value ratio is regarded as supplementary security.

8. Access to public agencies

Credit unions have requested that public agencies be permitted to carry on a full financial services relationship with a credit union, including placing deposits and borrowing. In many instances, while public agencies are able to deal with banks and trust corporations, their governing legislation does not list credit unions as permissible financial service providers. The ministry has reviewed all provincial legislation which recognizes banks as financial service providers and will be working with the ministries responsible for these Acts on proposals to place credit unions on an equal footing with banks.

V. SMALL AND LESS COMPLEX CREDIT UNIONS

With recent consolidation in the sector, some credit unions are choosing increasingly more complex business approaches than others. A one-size-fits-all approach to regulation may not be appropriate given these differences. In some cases, there may be little or no addition to system soundness and consumer protection from imposing complex regulatory requirements that require sophisticated compliance mechanisms. It may be appropriate to use simpler regulatory tools for less complex credit unions with respect to liquidity, capital and business power provisions.

It is proposed that less complex credit unions be defined as those credit unions with $50 million or less in assets and no commercial lending.

Regarding capital requirements, it is proposed that small and less complex credit unions have the ability to opt out of the Basel II capital test and be subject to a simple leverage test to assess capital adequacy as opposed to a dual test.

Less complex credit unions which have opted out of the Basel II capital requirement would not qualify for the prudent-person approach for liquidity but be subject to prescriptive rules. It is proposed that rules governing liquidity for these institutions be updated to reflect more current uses of financial instruments.

At the same time, it is proposed that lending licences and some prescriptive regulations on lending be retained for these institutions.

VI. REGULATORY OVERSIGHT

1. Promoting effective regulatory oversight

The mandate of the Deposit Insurance Corporation of Ontario (DICO) is to provide deposit insurance for depositors in credit unions. DICO is responsible for establishing and maintaining a deposit insurance reserve fund that is sufficient for the payment of deposit insurance claims, financial assistance to credit unions, or the liquidation of credit unions in difficulty. Among other things, DICO is also responsible for promoting standards of sound business and financial practices for member credit unions. In fulfilling these responsibilities, DICO may examine the affairs of member credit unions, and take appropriate steps, including requesting the Superintendent to place a credit union under DICO's supervision, to deal with problems such as insufficient capital or liquidity.

The Financial Services Commission of Ontario (FSCO) provides regulatory services that protect the public interest and enhance public confidence in the regulated sectors, including the credit union sector. Under the *Credit Unions and Caisses Populaires Act,1994,* the Superintendent of Financial Services may conduct examinations, approve lending licences, intervene in corporate governance matters, and issue compliance orders, including a requirement to increase capital, if a credit union is in contravention of the Act or regulations.

DICO and FSCO work together closely to ensure the safety and vibrancy of the credit union system. However, the current regulatory framework creates potential overlap regarding solvency regulation. In an effort to reduce this overlap, DICO and FSCO entered into a working relationship in 1999 in which DICO developed a comprehensive process for monitoring solvency and conducting on-site inspections of member institutions. The results of the monitoring process are shared with FSCO and may be used by DICO or FSCO (or both) to intervene in the affairs of a credit union. Since the implementation of the streamlined approach, DICO has developed sophisticated reporting and monitoring systems and expertise that have been relied upon by FSCO.

As the credit union sector has evolved since the current regulatory structure was implemented, vigilance is needed to keep the respective roles of each institution up to date, in order to ensure continued effectiveness and efficiency and to minimize any perception of potential for conflict of interests within each institution. A concept being explored is the possibility of clarifying the roles of DICO and FSCO to have a single focal point for solvency regulation.

In principle, many different models could be adopted. For example, one approach that could be explored would be to locate solvency regulation formally at DICO. While doing so, it could be appropriate to ensure that DICO's mandate reflects the context of a regulatory and deposit insurance regime that is consistent with a vibrant and robust credit union system while ensuring safety and soundness.

Another approach might be to consolidate the responsibility for solvency regulation at FSCO. This would require FSCO to reestablish the appropriate regulatory resources.

In addition, credit unions have requested that a position of director of credit unions be re-established at FSCO. If created, either at FSCO or DICO, such a position could play a role to promote effective regulatory oversight of the sector.

Factors that will be important in making a decision on these, and possibly other, approaches will include regulatory effectiveness, efficiency (including impact on the cost of regulatory compliance and on direct costs borne by the sector) and responsiveness to the service needs of the system.

2. Governance of DICO

Changes to DICO's governance are being considered. In particular, it may be appropriate to reduce the size of the board, for example from 11 to seven members, to reflect the decrease in the number of credit unions over the past several years. In addition, it is proposed that the nomination process for DICO's directors emphasize the relevant skills and expertise required to be an effective board member.

Consideration is also being given to amending the legislation to require DICO to inform the Minister of Finance or his delegate on issues affecting the stability of the sector and the adequacy of the reserve fund.

3. Stabilization

Under the current Act, DICO is the statutory "stabilization authority" for the Ontario credit union system, with early intervention and supervisory powers. DICO has the authority to delegate some or all of its stabilization powers to a designated stabilization authority (DSA), but in practice DICO has never delegated these powers.

It is proposed that a "voluntary stabilization" regime be introduced whereby leagues or associations of credit unions have the ability to establish stabilization funds on a voluntary basis without statutory governance. It is proposed that the governance of such stabilization funds be determined by their own by-laws and not be subject to regulatory approvals. The deposit insurer would, however, continue to be the statutory stabilization authority for the credit union system.

The voluntary model gives leagues and associations interested in a stabilization regime the flexibility to address their own needs without interference from government.

4. Flexibility with Interpretive Bulletins

In order to ensure flexibility while providing guidance on best practices, it is proposed that some regulations be removed and replaced with interpretive bulletins. Interpretive bulletins could be published by the regulator and updated as required. The bulletins could be used, for example, to facilitate effective and prudent management of liquidity and capital, and to prepare offering statements.

VII. MANDATORY REVIEW OF THE ACT

Over the course of the next few years, it is likely that financial markets, the financial services sector and credit unions will continue to develop along various paths. This may create the need for further evolution of the regulatory framework.

It is proposed to add to the legislation a requirement that the Minister appoint one or more people to review the Act, regulations, and administration of the regulatory regime. The review would be set to commence five years after the amendments to the Act come into effect. The appointee(s) would be required to solicit public input and to prepare a report for the Minister on the review and any recommendations. This report would be available to the public.

APPENDICES

Appendix 1: Summary of Proposed Risk-Weighting for Major Asset Classes

Asset	Basel II Approach for Ontario Credit Unions and Caisses Populaires	Current Ontario Capital Adequacy Requirement	Other Provincial Requirements[1]	OSFI's Position on Basel II Standardized Approach
Cash	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 1	0 per cent	0 per cent
Federal government or federal agency	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 2	0 per cent	0
Provincial or territorial government or agency	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 3	0 per cent	0
Claims secured by cash or government securities	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 4	0 per cent. British Columbia and Manitoba also zero rate claims collateralized by bank deposits	Under the credit-risk mitigation provisions of Basel II, the risk weighting of specified financial collateral may be substituted for the risk of the counterparty.
Residential mortgages insured under the National Housing Act or similar provincial act	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 5	0 per cent	0 per cent
Securities that are secured by mortgages and guaranteed by CMHC	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 6	0 per cent	0 per cent
Investments in bodies corporate that are accounted for in the credit union's financial statement using the equity method.	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 7	0 per cent	0 per cent
Any deductions from regulatory capital.	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 8	0 per cent	0 per cent

Asset	Basel II Approach for Ontario Credit Unions and Caisses Populaires	Current Ontario Capital Adequacy Requirement	Other Provincial Requirements[1]	OSFI's Position on Basel II Standardized Approach
Deposits with a league	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 9	All provinces zero-weight exposure to centrals (BC requires the central to have capital adequacy exceeding 10 per cent for a 0 weighting, otherwise 20 per cent weighting applies; and Alberta and Manitoba weight shares in a central at 100 per cent while deposits are zero-weighted)	No explicit position, but all non-bank financial institutions are weighted at 100 per cent in the Basel II simplified standardized approach.
Loans guaranteed by a community loan fund corporation	0 per cent	0 per cent Reg. 76/95, s. 15 (2) 10	British Columbia and Manitoba also weight at 0 sub-provincial government agencies. Other provinces weight at 20 per cent.	20 per cent.
Cheques and items in transit	20 per cent	20 per cent Reg. 76/95, s. 15 (3) 1	20 per cent	20 per cent
Claims against or guaranteed by a municipality, school board, university or hospital in Canada	20 per cent	20 per cent Reg. 76/95, s. 15 (3) 2, 3	British Columbia and Manitoba zero-weight municipalities, other provinces weight at 20 per cent.	20 per cent
Deposits in Canadian deposit-taking institutions	20 per cent	20 per cent Reg. 76/95, s. 15 (3) 4	Provinces weight credit unions, trust companies and banks at 20 per cent (except Manitoba, which has no explicit reference to direct exposure to deposit-taking institutions in its capital adequacy regulation).	Use national discretion to apply one category less favourable than the sovereign (20 per cent) to all banks. No explicit position on credit unions, but all non-bank financial institutions are weighted at 100 per cent in the Basel II simplified standardized approach.
Commercial paper, banks' acceptances, and similar instruments guaranteed by a deposit-taking institution in Canada	20 per cent	20 per cent Reg. 76/95, s. 15 (3) 5	Provinces weight credit unions, trust companies and banks at 20 per cent (except Manitoba, which has no explicit reference to direct exposure to deposit-taking institutions in its capital adequacy regulation).	Use national discretion to apply one category less favourable than the sovereign (20 per cent) to all banks. No explicit position on credit unions, but all non-bank financial institutions are weighted at 100 per cent in the Basel II simplified

Asset	Basel II Approach for Ontario Credit Unions and Caisses Populaires	Current Ontario Capital Adequacy Requirement	Other Provincial Requirements[1]	OSFI's Position on Basel II Standardized Approach
				standardized approach.
Uninsured first mortgages on residential dwellings of 1 to 4 units	35 per cent	50 per cent Reg. 76/95, s. 15 (4) 2	All provinces currently risk-weight residential mortgages at 50 per cent.	35 per cent
Uninsured second mortgages on residential dwellings of 1 to 4 units	35 per cent	50 per cent Reg. 76/95, s. 15 (4) 2	All provinces currently risk-weight residential mortgages at 50 per cent.	35 per cent
Uninsured collateral mortgages on residential dwellings of 1 to 4 units when no party other than the holder of the collateral mortgage holds a senior charge	35 per cent	50 per cent Reg. 76/95, s. 15 (4) 3	Generally similar.	35 per cent
Securities that are secured by mortgages not guaranteed by CMHC	35 per cent	50 per cent Reg. 76/95, s. 15 (4) 4	Generally similar.	35 per cent
Personal loans	75 per cent Exposures to businesses included as personal loans provided loan does not exceed the lesser of 3.5 basis points of assets or $1.25 million.	80 per cent Reg. 76/95, s. 15 (5) 1	British Columbia, Alberta, and Manitoba risk-weight personal loans at 80 per cent. Currently Saskatchewan weights personal loans at 100 per cent.	75 per cent, subject to: exposure to individual person(s) or small business, specified products excluding bonds and equities, sufficient granularity for risk diversification (granularity determined through supervisory review)
Agricultural	75 per cent Agricultural exposure would be treated in the same way as small business exposure, and thus included in the retail portfolio.	80 per cent Reg. 76/95, s. 15 (5) 2	Manitoba risk-weights agricultural loans at 80 per cent. British Columbia weights agricultural mortgages at 50 per cent, other agricultural exposure at 100 per cent.	75 per cent if qualifying for inclusion in the retail portfolio (see personal loans, above), otherwise included in the corporate portfolio (see commercial below).

Asset	Basel II Approach for Ontario Credit Unions and Caisses Populaires	Current Ontario Capital Adequacy Requirement	Other Provincial Requirements[1]	OSFI's Position on Basel II Standardized Approach
Commercial	100 per cent Applied to commercial loans exceeding the size limit for inclusion in the retail portfolio unless the counterparty has an external credit rating, in which case weighting consistent with OSFI's approach would apply. **Rating** — **Weight** AAA to AA- — 20 A+ to A- — 50 BBB+ to BB- — 100 Below BB- — 150	100 per cent Reg. 76/95, s. 15 (6) 1	Other provinces weight commercial loans at 100 per cent, except for some special treatment of agricultural loans (see above) and a penal weighting in British Columbia for commercial loans exceeding 30 per cent of assets (200 per cent), and a penal weighting of 150 per cent in Alberta on financing land for development.	Only some DTIs (presumably the smallest and least sophisticated) permitted to choose 100 per cent risk-weight in lieu of external ratings-based approach **Rating** — **Weight** AAA to AA- — 20 A+ to A- — 50 BBB+ to BB- — 100 Below BB- — 150 Unrated — 100
Other assets not specified	100 per cent	100 per cent Reg. 76/95, s. 15 (6) 2	100 per cent	100 per cent
Past due loans other than residential mortgages	150 per cent if specific provisions are less than 20 per cent of outstanding loan amounts, 100 per cent if specific provisions are at least 20 per cent of outstanding loan amounts, not exercise the discretion to reduce risk weight to 50 per cent if specific provisions are at least 50 per cent of outstanding loan amounts	Currently weighted depending on the asset type, e.g. commercial loan in default is weighted at 100 per cent, personal loan in default is weighted at 80 per cent.	No province currently has penal provisions for delinquent loans.	150 per cent if specific provisions are less than 20 per cent of outstanding loan amounts, 100 per cent if specific provisions are at least 20 per cent of outstanding loan amounts, not exercise the discretion to reduce risk weight to 50 per cent if specific provisions are at least 50 per cent of outstanding loan amounts

Asset	Basel II Approach for Ontario Credit Unions and Caisses Populaires	Current Ontario Capital Adequacy Requirement	Other Provincial Requirements[1]	OSFI's Position on Basel II Standardized Approach
Past due residential mortgages	100 per cent if specific provisions are less than 20 per cent of outstanding loan amounts, 50 per cent if specific provisions are at least 20 per cent of outstanding loan amounts	Currently weighted 50 per cent, consistent with the weighting for mortgages not in default	No province currently has penal provisions for delinquent mortgages.	100 per cent if specific provisions are less than 20 per cent of outstanding loan amounts, OSFI has not indicated whether it will exercise the national discretion to permit 50 per cent weighting if specific provisions are at least 20 per cent of outstanding loan amounts
Securitization (originating institution)	Adopt the same approach outlined in OSFI Guideline B-5 *Asset Securitization* (November 2004), subject to any subsequent revision in the final implementation of Basel II. First loss facilities to be deducted from capital Second or subsequent loss facility weighted as direct credit substitute or on-balance sheet exposure for the class of asset Credit conversion factor, varying with the nature of the facility, will apply to liquidity facilities.	Not specifically addressed	Not specifically addressed	Excluded from the calculation of risk-weighted assets only if: Significant credit risk associated with the exposures has been transferred to third parties; the originator does not maintain effective or indirect control over the transferred exposures; securities issued are not obligations of the transferor; the transferee is a special purpose entity and holders of the beneficial interest in that entity have the right to pledge or exchange without restriction; the securitization contains no requirements for the originator to alter the underlying exposures, increase first loss or credit enhancement, or increase yield in response to deterioration in the underlying pool. Capital charges will apply for positions retained by originators, credit risk mitigants and liquidity facilities.

Appendix 2: Credit conversion factors

Instruments[2]	Basel II Approach for Ontario Credit Unions and Caisses Populaires	Current Ontario Capital Adequacy Requirement (Guideline March 1, 1995)	Basel II
Direct credit substitutes (e.g. guarantees, standby letters of credit)	100 per cent	100 per cent	100 per cent
Transaction-related contingent items (e.g. performance bonds, bid bonds)	50 per cent	Not specified	50 per cent
Short-term self-liquidating trade contingencies (e.g. documentary credits)	20 per cent	Not specified	20 per cent
Repurchase transactions	100 per cent	Not specified	100 per cent
Commitments with an original maturity up to one year	0 per cent	0 per cent	20 per cent[3]
Commitments with an original maturity of greater than one year	50 per cent	Not specified	50 per cent

1 British Columbia, Alberta, Saskatchewan, Manitoba and Quebec currently have risk-weighted capital adequacy requirements.

2 Under Basel, off balance sheet items are converted to an equivalent on-balance sheet amount, to which the weighting applicable to an asset class is then applied to determine the capital requirement. For example, if a credit union issued a bid bond on behalf of a commercial customer in an amount of $100,000 the credit union would have to hold the same capital requirement as if it had extended a $50,000 loan to the customer: amount of bond ($100,000) multiplied by the conversion factor (50 per cent) multiplied by the weighting for the assets class (100 per cent) equals an on-balance sheet equivalent exposure of $50,000.

3 The only significant change in credit conversion factors between Basel I and Basel II is that committed facilities with a maturity of up to one year will have a conversion factor of 20 per cent under Basel II rather than zero under the original accord. Under Basel II, only undrawn facilities that are unconditionally cancellable at any time will attract a zero weighting.

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